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Using systematic bolt-on acquisitions to drive growth

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Companies seeking growth often balance between growing through organic business development, and inorganic growth through mergers and acquisitions. Organic development is slow, as it takes time to develop and launch new products and technologies, a new business line or broader geographic presence. Programmatic “bolt-on” acquisitions provide an alternative value creation path with manageable risk.

Companies seeking growth are often balancing between options of growing through organic product and business development, and inorganic growth through mergers and acquisitions. The problem with organic development is that it may take time to develop and launch new products and technologies, not to mention building a new business line or a broader geographic presence. The time required may be too long to meet the strategic ambition of the company. At the same time, the value creation of M&As, especially large-scale acquisitions, is considered extremely challenging. In many cases, small- to mid-sized acquisitions following bolt-on logic can be utilized to solve these pitfalls and drive growth. Typically, these “bolt-on” acquisitions provide a solid value creation path without exposing the acquirer to undue risk.

Bolt-ons – small focused acquisitions that fit directly into the acquirer’s existing platform

While large M&As are often complex and effortful, a “bolt-on” acquisition typically adds to only one dimension of the acquirer’s business. Bolt-ons add a missing item that can be easily “bolted” on to the acquirer’s existing business. Thus the existing business becomes stronger as it can leverage the existing assets more efficiently with the bolt-on element. Typical examples of bolt-ons are technology, brand, trademark, or product expansion acquisitions targeting to expand the offering portfolio and realize cost synergies through a common platform. Technology or skill development that aims to improve competitiveness through creating a more comprehensive, solution-type offering can be done through a bolt-on acquisition. Similarly, a value chain expansion acquisition can be considered as a bolt-on if, for example, a certain component manufacturer or technology is acquired to enhance the existing business. Due to the relatively small size of the bolt on acquisitions, integration can be done relatively fast, providing a rapid market entry, product line extension or capability development in comparison to organic development.

The Finnish technology company Outotec has actively pursued a strategy of acquiring small advanced technology companies, which it then has attached to its overall technology portfolio and distribution machinery for broader market access. A recent example is Outotec's acquisition of Larox, a Finland-based filtration company. The acquisition allowed Outotec to broaden its offering portfolio and fill a gap in it.

Brand and trademark acquisitions are also typical examples of bolt-ons that allow the acquirer to generate additional sales and gross margin with low additional overhead. Thus, they are attractive means for achieving growth and profitability improvement via economies of scale in logistics and manufacturing. For example, Altia, a Nordic alcoholic beverage manufacturer and distributor, has added new brands to its portfolio including Grönsteds and Renault cognac brands in 2009 and 2010 respectively. Similar expansion strategies have been successfully utilized by other alcoholic beverage companies such as SAB Miller and Diageo.

Success in bolt-on acquisitions requires understanding the existing business platform, its gaps, and how the bolt-on target fits in as a value driver

In addition to cost synergies driven by lower cost of goods sold and overhead utilization or reduction, a key value driver in bolt-on deals is often boosting sales of the acquired business through wider sales and distribution network of the larger company acquiring it.

Since the acquiring company is larger than the target it can utilize its larger purchasing power in materials and services purchased. Substituting the supply contracts of the acquired company with the acquirer's contracts may create value significantly. The more there is overlap on the supply side, the larger the potential synergies. In general, even small decreases in gross margin may create a significant boost in profitability, making supply side synergies the premier value driver. Thus, the value creation is most certain when the acquirer has strong negotiation power towards its material or component suppliers. However, as supply side synergies are fairly easy to assess, sellers tend to include them in their valuation of the business to begin with.

Improvements of capacity utilization at own production and logistics operations are another value lever related to bolt-ons especially in cases where a series of bolt-on acquisitions is done. Often "variable" production costs are not variable at least when considering incremental changes in volumes. The production and logistics volumes of small bolt-on acquisition may be added to the production platform with no extra headcount or investments.

While synergies can be significant and seem obvious, a common pitfall is to overestimate them. Normally, the acquired company is relatively small with low overheads. Thus, even a large relative cut from the overheads may be irrelevant when considered in absolute numbers. In technology bolt-ons, difficulties arise when the acquired company has its own production facilities which differ significantly from the acquirer's facilities. This is often the case when a company is acquired for its novel technology that broadens acquirer's offering, but current production capacity cannot be utilized in full by the acquirer. In this type of case, a joint venture or another form of collaboration with the target company may be more beneficial.

For bolt-on deals, sales increases are generated by cross- and/or up-selling opportunities. When companies have different customer bases there is an opportunity for cross-selling; the acquirer may start offering the new product to its existing customers or its own products to the acquired customers. In the case of up-selling the acquirer can bundle the new product with its existing products to increase their sales. Large IT-companies such as IBM have performed a number of acquisitions over the years where the rationale has been to distribute the target company's technology or complete product through their global distribution channels extremely fast and with significantly smaller investments than by establishing own sales and distribution operations. Cross- and up-selling opportunities are intuitively appealing concepts for rationalizing an acquisition. The problem with this is that cross- and up-selling are more uncertain than cost-side synergies and are typically overestimated. Before actually starting the sales operation you can only speculate on how the customers really react to the addition in the product portfolio whereas cost-side synergies can be verified before the acquisition.

A systematic program-based approach to grow through bolt-on acquisitions supports value creation for the long term

Although assessing the overall rationale and synergies for bolt-on deals should be more straightforward and accurate than for larger transformational acquisitions, the typical pitfalls in overestimating synergies and cross- and up-sell opportunities still exist; paying too much because of "deal fever", and lack of focus on long term value creation. A key difficulty in value creation is the value appropriation between the buyer and the seller. When seller can assess the synergies and revenue effects easily, it may include them in the valuation increasing the asked price for the company and its assets. Value creation as such does not diminish, but the seller gets a larger share.

While individual M&A deals are difficult to plan ex ante, a program-type approach provides potentially a better result than focusing on single targets when it comes to bolt-on opportunities. The first step is to understand the ambition and direction of the company, and what gaps in, for example, the technology, or the offering the company has to fulfill to reach its ambition. The second step is to develop an understanding on which gaps can be filled with M&A and which need to be filled organically through internal development. This includes assessment of potential product and service offering additions, assessment of make or buy decisions, and mapping of potential acquisition targets to fill the gaps in offering.

When the view on potential acquisition targets is created, one can generate an overall roadmap based on potential structural options. This allows the buyer to build scenarios on how the sequence and targets of bolt-on acquisitions can vary to best suit the company's targets. In addition, this allows following up the identified targets, and approaching them in a systematic way when the time is right. The program based approach leaves more time for strategic consideration, and planning of alternative scenarios than exploring mere individual opportunities. If cases are assessed individually on ad-hoc basis, the strategic focus may be lost and the acquirer may end-up paying too much as the target evaluation is done in a hurry. Often, when additional options are not in sight, the management is struck with deal fever causing it to overlook important aspects and drive blindly towards the acquisition.

The execution of an M&A program requires competence in pre-deal and post-deal M&A which may not exist in a company that has done business building primarily by organic means. Some companies have built ”M&A factory” units to professionally manage the M&A process. This type of in-house competence should be considered especially when a series of bolt-on acquisitions is planned. Finally, while bolt-ons are relatively small, one should not overlook the importance of a well planned and executed post merger integration (PMI). To ensure a successful integration, the integration process should begin already before the actual deal is closed.